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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Price Cap Performance Review	)	
for Local Exchange Carriers;	)	CC Docket No. 94-1
Treatment of Video Dialtone Services	)	
Under Price Cap Regulation	)	

REPLY TO OPPOSITIONS

Cox Enterprises, Inc. ("Cox"), by its attorneys, hereby submits its reply to oppositions to its Petition for Reconsideration ("Petition") of the *Second Report and Order* in the above-referenced proceeding.[1/]

I. INTRODUCTION

In the *Second Report and Order*, the Commission required LECs with more than *de minimis* video dialtone costs to create a separate video dialtone price cap basket. In its Petition, Cox demonstrated that the establishment of a separate video dialtone price cap basket will not be effective in preventing cross-subsidization of video dialtone unless the Commission also prescribes how local exchange carriers ("LECs") are to allocate the common costs of network rebuilds necessary to provide video dialtone services.[2/] Cox then established that

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1/ *Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Services Under Price Cap Regulation*, Second Report and Order and Third Further Notice of Proposed Rulemaking, CC Docket No. 94-1, FCC 95-394 (rel. September 21, 1995) ("*Second Report and Order*").

2/ The Commission's decision to establish a separate price cap basket for video dialtone reflects its concern about cross-subsidization, but some LECs nevertheless continue to argue that the election of a no-sharing option under the LEC price cap rules eliminates any potential for cross-subsidy. Pacific at 2; Bell Atlantic at 2-3. These arguments ignore the fact that the no-sharing option is elected on an annual basis so that any LEC could become subject to sharing in the future. In addition, the fact that the productivity factor is based on

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allocating a minimum of 50 percent of network rebuild costs to video and a maximum of 50 percent to telephony was a reasonable, administratively simple method of reducing the potential for cross-subsidization that exists under the current regime. Cox also demonstrated that the *de minimis* exception created by the Commission would increase both the potential for cross-subsidization of LEC video dialtone facilities and the administrative burden of the separate basket requirement.

The Cox Petition was opposed by Bell Atlantic, NYNEX, Pacific Bell and Southwestern Bell (collectively the "LECs"). These oppositions highlight the problems with the existing regulatory regime and demonstrate why a prescribed allocation of common costs is needed to ensure that the separate price cap basket created by the Commission functions as intended. In addition, the LEC arguments supporting a *de minimis* exception to the separate price cap basket requirement show that the LEC's motive is to avoid completely the Commission's requirements. Consequently, the Commission should reject the LEC claims, adopt the cost allocation methodology proposed by Cox and eliminate the *de minimis* exception.

II. A PRESCRIBED ALLOCATION OF LEC NETWORK REBUILD COSTS IS NECESSARY TO PROTECT TELEPHONE COMPANY RATEPAYERS AND COMPETITORS.

A. The Principles Underlying Cost Allocations Should be the Same for all LECs and Need Not Vary Based on a LEC's Individual Circumstances.

A number of LECs opposed the Cox 50/50 proposal on the grounds that a uniform approach to cost allocations cannot effectively be applied to the various network configurations

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costs provides an independent incentive to misallocate video costs to telephone services. Consequently, these arguments are entirely without merit.

the LECs will deploy for video dialtone.[3] To support this position, the LECs rely primarily on the Commission's decision in the *Video Dialtone Reconsideration Order* not to prescribe cost allocation procedures.[4] That decision, however, was made at a time when not a single video dialtone tariff had been filed. Now that the Commission has more experience with video dialtone, it is apparent that granting LECs flexibility in how common costs are allocated is certain to result in allocations that unfairly burden telephone customers and minimize the portion of common costs recovered from video customers and LEC shareholders.

For example, in Omaha, Nebraska, U S West proposed allocating to video 50 percent of the common costs for each subscriber that takes video service and none of the common costs for subscribers that do not take video service.[5] Similarly, SNET has proposed allocating common costs based on the ratio of video lines to telephone plus video lines.[6] Both of these cost allocation schemes are based on the penetration level of video dialtone and have absolutely nothing to do with network configuration. The result of these allocation proposals is that telephone customers will bear an unreasonable portion of the costs of network rebuilds necessary to provide video service. For example, a 28 percent penetration rate would result in 86 percent of common costs being allocated to telephone customers under the U S West plan and 78 percent of common costs being allocated to telephony under the SNET proposal. Even

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3/ Pacific at 5; NYNEX at 6-7; Bell Atlantic at 5-6.

4/ *Telephone Company-Cable Television Cross-Ownership Rules*, Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking, 10 FCC Rcd 244 (1994) ("*Video Dialtone Reconsideration Order*").

5/ *U S West (Revisions to Tariff F.C.C. No. 5)*, Transmittal No. 613, Description and Justification at 2-10.

6/ *Southern New England Telephone Company*, W-P-C 7074, Application of Southern New England Telephone at 19.

higher allocations to telephony would result at the lower penetration rates anticipated in the initial years of video dialtone.

The one case in which a LEC has proposed to base its allocation of common costs on network architecture demonstrates the tremendous potential that this approach also creates for manipulation of cost allocations. For its video dialtone venture in Dover, New Jersey, Bell Atlantic has proposed to allocate common costs based on the ratio of dedicated video costs to dedicated telephone costs. As the Commission recognized when it suspended Bell Atlantic's tariff, this allocation methodology gives Bell Atlantic every incentive to structure its network in a manner that minimizes dedicated video costs, with the possible result that *no* common costs of this video network would be assigned to video.[7/]

LEC arguments that cost allocation issues should be addressed only in the tariff review process also must be rejected.[8/] The allocation of costs of LEC network rebuilds is a public policy decision and the principles that guide that decision are not dependent on the individual circumstances of the LEC. Because cost allocations need not be tailored to an individual LEC's network architecture, the tariff review process is not the best place to address these issues. While review of LEC cost information is needed during tariff review to ensure that LEC prices are lawful and in compliance with Commission requirements, a prescribed allocation of common costs relieves the Commission of the administrative burden of addressing LEC cost allocation proposals on a case-by-case basis and best protects the public interest.

7/ *Bell Atlantic Telephone Cos. (Revisions to Tariff F.C.C. No. 10)*, Transmittal Nos. 741, 786, Order, DA 95-1285 at ¶ 33 (rel. June 9, 1995) ("*Dover Suspension Order*").

8/ NYNEX at 7; Pacific at 5-6.

B. LEC Explanations of the Adequacy of the Existing Part 36 Rules Are Unconvincing.

As explained in Cox's petition, if telephone and video costs are not separated prior to the jurisdictional separations process, state regulators will face the burden of attempting to determine what portion of intrastate costs are in fact attributable to video dialtone, a service that is predominantly interstate in nature.[9/] The LECs, however, argue that a prescribed cost allocation is not needed because the existing Part 36 rules effectively allocate costs between jurisdictions.[10/] Bell Atlantic, for example, states that all video dialtone cable and wire investment will be placed in Category 2 and assigned to the interstate jurisdiction.[11/] This statement is meaningless, however, if the substantial majority of the common costs of network rebuilds are allocated to telephone service (and presumably placed in Category 1), as Bell Atlantic has proposed.[12/]

NYNEX also states that no changes are needed because Part 36 requires costs to be allocated between categories based on "service connections."[13/] This interpretation of Part 36 shows the inadequacy of the current rules and the need for a Commission-prescribed allocation of common costs. LECs will have few video "service connections" in the early years (when costs are highest) and therefore most costs will be assigned to telephony under this approach. This allocation proposal is comparable to the flawed proposals advanced by U S West and

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9/ Petition at 3-4

10/ Bell Atlantic at 5-6; NYNEX at 6.

11/ Bell Atlantic at 6-7.

12/ *Dover Suspension Order* at ¶ 32 (72 percent of common costs allocated to telephony).

13/ NYNEX at 6.

SNET in their tariffs which assigned costs to video based on the number of video customers, thus placing the substantial risk associated with the service on telephone customers.

The NYNEX proposal makes plain that the Part 36 rules do not work when applied to integrated broadband facilities. Indeed, the Commission recognized this in the *Video Dialtone Reconsideration Order.*[14/] While the Commission promptly should initiate the proceeding on jurisdictional separations promised in the *Video Dialtone Reconsideration Order*, it also must prescribe an allocation of common costs to prevent misallocation at the expense of telephone ratepayers.

C. The Cox 50/50 Proposal Is a Reasonable, Administratively Simple Solution to the Problem of Video Dialtone Cost Allocation.

A number of LECs claim that Cox's proposal to amend Part 64 to require an allocation between video dialtone and telephone costs reveals a "misunderstanding" of how the Part 64 rules work.[15/] There is no such misunderstanding on Cox's part. Cox is fully aware that Part 64 is intended to prevent customers of regulated telephone services from bearing the costs of LEC ventures into nonregulated businesses, such as cable television.

The Part 64 rules, however, were adopted well before the LECs began proposing to build broadband networks capable of transmitting voice, video and data services on an integrated basis. In its current form, Part 64 is not suited for separating video costs from telephone costs, which is what is required to protect telephone ratepayers. Neither the

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14/ "[W]e do not mean to imply that we will never revisit Part 36. Indeed, it appears likely that, as telecommunications networks and the marketplace evolve, the separations rules will require revision." *Video Dialtone Reconsideration Order*, 10 FCC Rcd at 333.

15/ Bell Atlantic at 4-5; NYNEX at 4.

Commission nor the LECs have ever explained why telephone customers that are protected by Part 64 when a LEC rebuilds its network to provide cable service are not entitled to the same protection when the LEC rebuilds its network to provide video dialtone -- yet this is the perverse outcome that results under the existing rules. The dichotomy is particularly troubling as it becomes increasingly evident that LEC video dialtone systems are virtually identical to cable systems and that LECs strongly desire to program channels on these networks.[16/]

The Cox 50/50 proposal corrects this flaw by separating telephony from video costs *first*, and then applying Part 64 to separate regulated video from nonregulated video and regulated telephony from nonregulated telephony. Furthermore, the Cox 50/50 proposal is a reasonable, administratively simple middle ground between the competing interests of LECs, ratepayers and competitors. Bell Atlantic's claim that Cox's proposal is "wholly arbitrary" is totally meaningless given Bell Atlantic's acknowledgment elsewhere that *any* methodology for the allocation of common costs is inherently arbitrary.[17/]

As noted above, cost allocation is a matter of public policy and the responsibility of this Commission. By giving LECs the discretion to allocate costs as they choose, the Commission has adopted a policy that burdens telephone ratepayers so that LECs can subsidize their entry into the video market without bearing the risks associated with their investments.

16/ In Omaha, for example, customers are being offered a single set of programming packages under the U S West brand name. From a technical and marketing perspective this service is indistinguishable from cable service and not a single reason has been advanced for subjecting it to different accounting treatment than a LEC-owned cable system.

17/ "As the Commission has acknowledged, any method of allocating shared costs is, by definition, arbitrary." *Bell Atlantic Telephone Cos. (Revisions to Tariff F.C.C. No. 10)*, CC Docket No. 95-145, Direct Case of Bell Atlantic at 2 (filed October 26, 1995), *citing, Video Dialtone Reconsideration Order*, 10 FCC Rcd at 345.

The separate price cap basket established in the *Second Report and Order* can help prevent this result, but only if the Commission prescribes how LECs are to allocate the common costs of their network rebuilds, as proposed by Cox in its Petition.

III. THE *DE MINIMIS* PROPOSALS ADVANCED BY THE LECs WOULD OBLITERATE THE SEPARATE PRICE CAP BASKET REQUIREMENT.

Cox demonstrated in its Petition that the Commission's proposal to create a *de minimis* exception to the separate price cap basket requirement was totally unfounded and would not serve the public interest.[18/] The LECs, however, argue that the Commission has used *de minimis* exceptions in previous decisions regarding the regulation of LECs and that it should do so in this case as well. NYNEX and Pacific Bell, for example, argue that the Commission previously has used a *de minimis* exception in calculating a LEC's rate of return and Southwestern Bell states that there is a *de minimis* exception for incidental activities under the Part 64 rules.[19/]

Although the Commission previously has used a *de minimis* exception, the reasons that justified such an approach in those cases do not apply here. The rate of return buffer cited by NYNEX and PacBell was created because the determination of cost of capital is not precise and varies over time.[20/] In contrast, accounting for costs and revenues of video dialtone should be precise and should not vary over time. The *de minimis* exception for incidental

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18/ Petition at 6-7.

19/ Pacific at 3-4; NYNEX at 3; Southwestern Bell at 4.

20/ *American Telephone and Telegraph Company, Petition for Modification of Prescribed Rate of Return*, 86 F.C.C. 2d 221, 250 (1981) ("during periods of volatile economic and financial conditions, it is unreasonable to expect that a carrier's tariffs will result in earnings by category of service which will exactly yield the prescribed rate of return.")

activities cited by Southwestern Bell is similarly inapplicable. This *de minimis* rule does not apply to incidental activities related to lines of business, such as video dialtone, which are always assigned to non-regulated, no matter how small the amount.[21] Thus, the decisions cited by the LECs do not support the establishment of a *de minimis* exception to the separate price cap basket requirement adopted in the *Second Report and Order*.

Cox also explained that the *de minimis* exception would place an additional burden on the Commission in terms of monitoring whether a LEC had sufficient video dialtone costs to trigger the requirements adopted in the *Second Report and Order*.[22] Apparently acknowledging that a threshold based on video dialtone costs would be burdensome for the Commission to monitor, a number of LECs propose alternative thresholds, such as households served or video dialtone revenues.[23] These proposals would obliterate the requirement adopted in the *Second Report and Order* and must be rejected. If the threshold is based on the success of video dialtone, such as revenues or households served, the majority of costs will be incurred and imposed on telephone customers before the threshold even is triggered. Indeed, in some cases, entire networks could be built without triggering the separate basket requirement. Consequently, while Cox demonstrated that a *de minimis* exception is totally unfounded, it is plain that one based on revenues or households unquestionably would not be in the public interest.

21/ *Separation of costs of regulated telephone service from costs of nonregulated activities*, Report and Order, 2 FCC Rcd 1298, 1308 (1987).

22/ Petition at 6.

23/ Southwestern Bell at 5 (percentage of households passed); Bell Atlantic at 4 (video dialtone revenues).

IV. CONCLUSION

The Commission established the separate price cap basket requirement to ensure that telephone customers are not burdened with video dialtone costs, but this objective cannot be achieved unless the Commission prescribes a methodology for allocating the common costs of LEC network rebuilds. Cox demonstrated that a 50/50 allocation is a reasonable, administratively simple method of achieving this objective and nothing in the LEC oppositions proves otherwise. Indeed, the LEC oppositions confirm that the existing rules are inadequate and that LECs are seeking to use the *de minimis* exception to avoid the separate basket requirement. A prescribed allocation of costs is the best way to ensure the separate price cap basket works as intended and the Commission should adopt the allocation methodology proposed by Cox. In addition, the Commission should eliminate the increased potential for cross-subsidization caused by the *de minimis* exception.

Respectfully submitted,

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CERTIFICATE OF SERVICE

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